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June 19, 2006

AGENDA ITEM 5a

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** AIM Strategic Review Implementation Update
- II. PROGRAM:** Alternative Investment Management (AIM) Program
- III. RECOMMENDATION:** Information Only
- IV. ANALYSIS:**

At the October 2005 Investment Committee meeting, the Investment Committee adopted the strategic review of the AIM Program conducted by Pension Consulting Alliance (PCA). The Investment Committee directed AIM Staff to provide a quarterly status update regarding implementation. This agenda item represents the second update. PCA is providing consulting services in connection with the implementation.

The key findings of the strategic review were to:

- 1) Reduce the number of relationships managed by AIM Staff
- 2) Utilize new vehicles managed by 3rd parties to make smaller investments
- 3) Transition the organizational structure
- 4) Enhance delegated authority
- 5) Explore co-investment strategies
- 6) Evaluate and enhance use of external resources
- 7) Evaluate AIM benchmarks

The following represents an update with respect to these key elements:

- **Reducing relationships** – The strategic review recommended reducing the number of relationships managed by AIM Staff. Staff has tentatively identified those relationships that are core, prospective core, and legacy. Legacy relationships are those that will no longer be managed by the AIM Unit. Staff has issued a Request For Information (RFI) to evaluate options, managers, and other transactions (which may include a secondary sale of some of the partnerships) with respect to the legacy portfolio. Staff and PCA expect the manager or transaction selection process to be complete during the third or fourth quarter of 2006.
- **Utilizing new vehicles for smaller investments** – The strategic review recommended leveraging 3rd parties for smaller investments. New Vehicles are commonly structured as fund-of-funds or separate accounts. AIM issued two Requests for Information in late March covering the following mandates: middle market; domestic emerging manager; global emerging markets; venture capital; California-focused markets; clean energy and technology, and; management of selected partnerships in the AIM portfolio.

One hundred sixty-one RFIs were sent to participants in the private equity markets that staff and the consultant believed would be interested in responding. In addition, ads were run in the two April editions of *Pensions & Investments* informing interested parties that the RFIs were available on CalPERS web site. Information about the New Investment Vehicle was downloaded 717 times; the management of selected partnerships, 460 times, and; the questions and answers, 336 times.

The due date for responses was April 28, 2006. AIM received 95 responses with each respondent applying, on average, for two mandates. Staff and the consultant are evaluating the responses, interviewing and visiting with the better ones, and awarding the mandates to the groups that manifest the highest probability of successfully discharging them. The evaluation and interview process for three of the mandates should be virtually completed by June 30 with the remainder following over the next two to three months.

- **Transitioning the organizational structure** – The organizational structure proposed in the action plan has formally been put in place, and roles and responsibilities are currently being realigned. The AIM Unit has hired two Portfolio Managers, Mike Dutton and John Greenwood. In addition, Yingru Li was hired as an Investment Officer II. AIM is currently recruiting for two Investment Officers and will have another Portfolio Manager Position open

with the start of the new fiscal year. Candidates for all three positions are currently being interviewed. Additional positions may be required during the next fiscal year to accommodate growth in the AIM program.

- **Enhancing delegated authority** – At the April 17, 2006 Investment Committee meeting Staff requested and received approval to enhance delegated authority in a manner consistent with the recommendations in the strategic review.
- **Exploring co-investment strategies** – Implementation of this finding is a lower priority from a timing standpoint. Staff expects to begin evaluating options with respect to co-investing in the third or fourth quarter of 2006.
- **Evaluating use of consultants** – The AIM Unit is working with PCA to develop a new evaluation process for its external resources (e.g., consultants). The new evaluation process would be conducted annually beginning at fiscal year end 2005/2006. In addition, AIM is in the final stages of the contracting process for refreshing its spring fed pool of external resources. Staff completed an RFP for the consultant pool, selected 13 finalists, and is currently working through the contracting phase.
- **Evaluating AIM benchmarks** – At the April 14, 2006 Policy Subcommittee meeting Staff recommended a revision to the AIM long-term benchmark. The Subcommittee approved the recommendation at that meeting and the revision was approved by the Investment Committee at the May 15, 2006 meeting.

Implementation of the strategic review remains the highest priority of the AIM Unit. The timing noted in this agenda item is Staff's and PCA's best estimate. Staff and PCA endeavor to complete tasks ahead of plan.

V. STRATEGIC PLAN:

Goal VIII, manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions and Goal IX, achieve long-term, sustainable, risk-adjusted returns.

VI. RESULTS/COSTS:

None. This agenda item is for information purposes only.

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